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IN THE

Supreme Court of the United States

October Term, 1940

No. ~~362~~ 8

UNITED STATES OF AMERICA,
Petitioner,

v.

BETHLEHEM STEEL CORPORATION, BETHLEHEM SHIPBUILDING CORPORATION, LTD., BETHLEHEM STEEL COMPANY, FORE RIVER SHIPBUILDING CORPORATION, UNION IRON WORKS COMPANY.

No. ~~363~~ 9

UNITED STATES SHIPPING BOARD MERCHANT FLEET CORPORATION,
Petitioner,

v.

BETHLEHEM SHIPBUILDING CORPORATION, LTD.

BRIEF IN OPPOSITION TO PETITION FOR WRITS OF CERTIORARI

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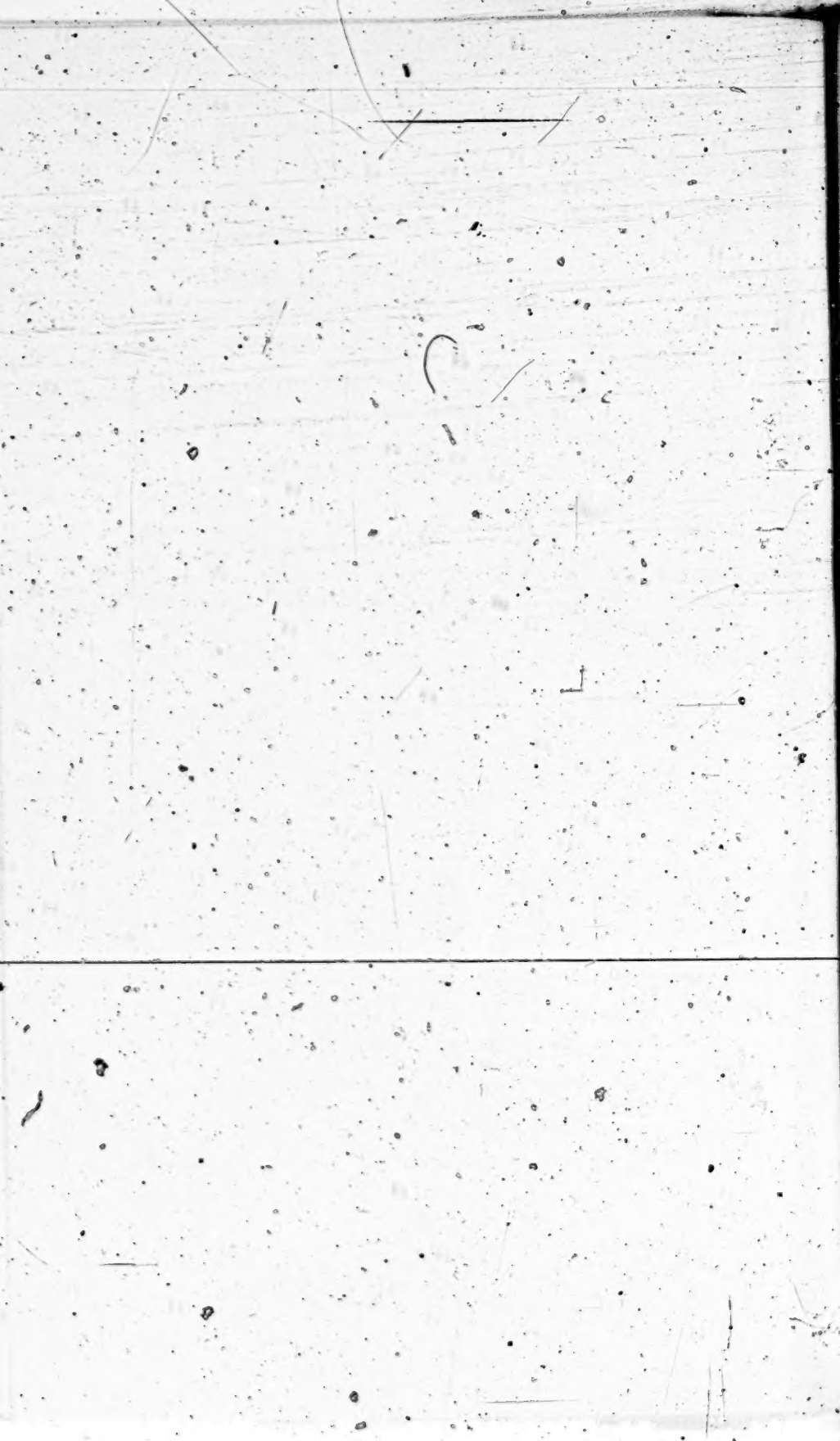

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BRIEF IN OPPOSITION TO PETITION FOR WRITS OF CERTIORARI

The petition seeks writs for review of two cases, a suit in equity and an action at law, which were tried together before a Special Master and Referee, who will be hereinafter referred to as the Master. Bethlehem Shipbuilding Corporation, Ltd., which is the sole respondent in the law action and is also the respondent chiefly concerned in the equity case, will be hereinafter referred to as Bethlehem.

The petitioner in the law action, United States Shipping Board Merchant Fleet Corporation, will be sometimes hereinafter referred to as the Fleet Corporation.

THE QUESTIONS PRESENTED

Contracts made in 1918 by Bethlehem with the Fleet Corporation for the construction by the former of a large number of ships provided for payment to Bethlehem for each ship of the cost of construction of the ship, plus a fixed fee, plus one-half of the amount by which the cost should be less than an amount of estimated cost specified in the respective contracts. The courts below found that the amounts of estimated cost specified in the contracts represented reasonable estimates of probable costs.

The questions presented are:

1. Whether the courts below should have held the contracts to be unconscionable because Bethlehem in the performance of them earned substantial profits under the "half savings" clause;

2. Whether the courts below should have held the "half savings" clause of such contracts to be severable from the other provisions thereof for the payment of compensation to Bethlehem and that there was failure of proof that the Fleet Corporation derived benefit from that clause in the performance of the contracts;

3. Whether the courts below should have held the "half savings" clause in such contracts to be invalid as opposed to public policy and the contracts containing such clause to be beyond the authority of officers of the Fleet Corporation to make.

STATEMENT OF REASONS WHY PETITION SHOULD BE DENIED

1. The petitioners contend in their petition that the contracts therein referred to are unconscionable because of the amount of profit earned by the Contractor pursuant to the provisions of the contracts. That contention necessarily involves the question of fact whether the amounts of estimated costs specified in the contracts were, at the time such contracts were made, in excess of probable cost and known to the Contractor to be such. That question of fact has been decided against the petitioners by the Master, by the District Court and by the Circuit Court of Appeals. This Court has repeatedly declared that findings of fact concurred in by two lower courts will be accepted by this Court, unless clear error is shown. The petition does not suggest that the finding of the courts below is not supported by ample evidence. It seeks to have this Court draw the inference solely from the amount of such profit earned by the Contractor that the estimates were inflated—an inference that would be directly contrary to the findings of the courts below (pp. 17-19, *post*).

2. The question whether the contracts are unconscionable must be determined in the light of conditions existing when they were made—not on the basis of the amount of profit earned by the Contractor. The courts below found that the form of contract adopted was advantageous both to the Fleet Corporation and Bethlehem by reason of the incentive it provided to keep down the total cost to the former. They also found that the amounts of estimated cost specified in the contracts represented reasonable esti-

mates of probable cost and were in accordance with the intention of both parties. They further found that the cost to the Fleet Corporation of the ships constructed by Bethlehem under the contracts was less than the cost of comparable ships currently built for the Fleet Corporation by other shipbuilders. The Government thus got what it bargained for and in the way in which it hoped to get it, viz.: through the operation of the half-saving clause. The foregoing findings dispose also of the contentions that the contracts are opposed to public policy and were beyond the authority of the officials of the Fleet Corporation to make (pp. 19-27, *post*).

3. The petitioners also contend in their petition that the provisions of the contracts for payment of compensation to the Contractor can be severed and that the provision for payment to it of one-half of the saving under estimated cost requires proof of separate consideration in the performance of the contract. On that contention there is no conflict between the decision of the Circuit Court of Appeals and that of another Circuit Court of Appeals. On the contrary, the decision in this case is in accord with that of the only other Circuit Court of Appeals that has considered the question. The decision of the Court of Claims in the *Burke & James, Inc.* case, cited in the petition, is readily distinguishable (pp. 27-31, *post*).

4. The petitioners suggest (petition, p. 12) that the conditions of our present national emergency are such as to require this Court to define the limitations surrounding the profits which a Government contractor may lawfully receive or retain in time of war. We had supposed and believe that it is exclusively within the province of the Congress to define such limitations—by statute, by pre-

scription of contract provision or limitation, by the provision of an excess profits tax, or by all three methods combined.

Carried to its logical conclusion the contention of the Government would appear to be that this Court, independent of any statutory limitation of profits, should declare that, as a matter of law, no Government contractor, in time of war or at any other time—no matter what the terms of his contract may be or what benefits may be derived therefrom by the Government—may receive or retain any profits in excess of that which the courts shall subsequently determine to be reasonable. No authority is cited in support of that startling contention, which, if correct, would transfer the determination of prices in Government contracts from the executive to the judicial department and the determination of questions of policy, in respect of such contracts, from the Congress to the courts.

It is respectfully submitted that no considerations of public policy, past, present or future, either require or warrant the assumption of jurisdiction by this Court over cases whose determination depends almost entirely, if not entirely, upon questions of fact, all of which have been resolved against the petitioners by the Master, the District Court and the Circuit Court of Appeals, and which present no novel or unsettled question of law (pp. 31-32, *post*).

STATEMENT

Between about February 1, 1918, and a date subsequent to July 15, 1918, as of which date the last of them was dated (R. 295), Bethlehem entered into 18 separate contracts with the Fleet Corporation under which it con-

structed 83 ships of various types and sizes. 8 of such contracts, covering the construction of 51 ships, which were dated December 31, 1917, and were executed February 1, 1918 (R. 552, 589), resulted from negotiations carried on between representatives of Bethlehem and those of the Fleet Corporation, both in writing and orally, that began on December 12, 1917, and were finally brought to a conclusion at a conference on January 3, 1918. In such negotiations Bethlehem was represented by Powell, its Vice-President, and Brown, its Technical Manager, both competent shipbuilders, and, as found by the Master, the Fleet Corporation was represented by "two equally competent shipbuilding experts", Admiral Bowles and G. S. Radford, who "were advised by, and had full opportunity to advise with, Daniel H. Cox, a competent naval engineer and estimator". The interests of the Fleet Corporation were also protected by Piez, its "Vice-President and General Manager, who, while not a shipbuilder of experience, was a nationally known business executive of long experience" (R. 527).

The remaining 10 of such 18 contracts were entered into subsequent to February 1, 1918. 8 of such 10 contracts covered the construction of ships of types and sizes similar to some of the ships covered by the earlier contracts. As is hereinafter shown, the terms of such 8 later contracts as to the compensation to be paid to Bethlehem were in each case determined by the Fleet Corporation, and in the case of most of them such terms reflected a reduction determined by it from corresponding terms provided in respect of similar ships in the earlier contracts.

The 13 contracts referred to in the petition (p. 7 footnote) are a part of the 18 contracts above mentioned. 7 of such 13 contracts were among the earlier 8 contracts and

the other 6 were among the above-mentioned 8 later contracts. Of the remaining 5 out of the 18 contracts, one of the earlier ones (Contract 182) and one of the later ones (Contract 465) are not involved in any controversy and 3 others of the later contracts were canceled before any ships were completed under them. There was also cancelation in respect of certain ships under 2 of the other contracts after some expense had been incurred on them.

In the action at law Bethlehem has recovered judgment in the amount of $5,272,075.10, the unpaid amount found due to it on account of the ships completed under the contracts and on account of the part-performance by it of the canceled contracts and partial construction of the ships canceled under other contracts.

By stipulations of the parties, introduced into the record (Exhibits A, B and D, R. 1642, 1713 and 1721), the following amounts were conceded to be due to Bethlehem on account of contracts other than the 13 contracts referred to in the petition and are included in the amount of the judgment, namely:

For completed ships:		
Under Contract 182 S. C.		$ 178,989.03
Under Contract 465 S. C.		935,306.22
For canceled ships and contracts:		
Under Contract 465 S. C.	$286,462.49	
Under Contract 313 S. C.	84,044.29	
Under Contract 340 S. C.	286,173.58	
	$656,680.36	
Less overpayments on canceled Contract 312 S. C. and on ships canceled from Contract 301 S. C.	147,473.50	509,206.86
		$1,623,502.11

Bethlehem's recovery also includes (Master's report, R. 570) the following additional amounts claimed in its Nineteenth and Twentieth causes of action (R. 104-107) and admitted to be due to it (Exhibit D, par. 5, R. 1722 and 1631-1632):

For Curtis marine propelling equipments (also referred to as Perley Morse deduction)	$ 90,019.25
For reconditioning property at Wilmington	2,570.00
The total undisputed amount included in Bethlehem's recovery of $5,272,075.10 is, therefore	$1,716,091.36

Hence, to the extent of $1,716,019.36, which amount concededly is due under contracts not included among the 13 referred to in the petition, Bethlehem's right of recovery was not in dispute in the courts below and cannot be brought into question here; and the statement contained in the petition that Bethlehem has recovered judgment for $5,272,075.10 as additional profit under such 13 contracts is patently inaccurate.

In the negotiations that led up to the 8 contracts above-mentioned which were dated December 31, 1917, Powell on December 12, 1917, had a conference with representatives of the Fleet Corporation at which he was directed to submit a program of what Bethlehem could do in the way of completing ships in addition to those that it then had under construction. Following that conference, Powell submitted to the Fleet Corporation a letter, dated

December 13, 1917 (Exhibit G-104, R. 1806), outlining several alternative programs for each of the Bethlehem yards. In that letter he said:

> "Because of the unprecedented conditions surrounding the Labor and Material market, *it is impracticable to estimate within a reasonable percentage what will be the actual cost of construction*, and it is therefore impossible to submit fixed prices for any of these vessels, except upon a basis so far above estimated cost that any figures acceptable to this Company would not be acceptable to the Emergency Fleet Corporation." (Italics supplied.)

He accordingly proposed that the contracts should be taken on the basis of actual cost plus a fixed fee with an agreed probable cost, any savings under the agreed-upon probable cost to be divided equally between Bethlehem and the Fleet Corporation. He then went on to say:

> "The basis of fees and estimated cost to be such as to offer a reasonable probability of a net earning *after paying all War and Excess Profit taxes* as today existing, of Ten Percent (10%) of the present estimated cost of construction." (Italics supplied.)*

On December 18, 1917, Powell had another conference with Admiral Bowles at which a definite program was agreed upon and Powell was instructed to submit proposals at once (R. 685). Prior thereto and in the Fall of 1917, Powell had instructed Brown to be prepared to submit estimates for such types of ships as Bethlehem might be

*The percentages of profit set forth in the petition for writs of certiorari are before, not after, excess profits taxes.

called upon to build (R. 681). The methods used by Brown in preparing his estimates, based on the cost of ships previously constructed, are fully explained in Exhibits G-154 and G-155 (R. 1852, 1854), supplemented by Brown's testimony (R. 840-865, 1041-1060, 1063-1073, 1082-1083). The courts below have found that, in view of the uncertainty of conditions affecting costs then existing, it was impossible to make an accurate estimate of cost (R. 681), and that Brown's estimates were fairly and honestly made and were as accurate as could be expected under the uncertain conditions prevailing at the time (R. 683).

On December 19, 1917, Powell submitted a definite proposal based on the form of contract suggested in his letter of December 13, 1917 (R. 685) for the construction of the ships afterwards covered by the contracts hereinafter referred to which were dated December 31, 1917. The estimated base cost proposed in that letter was based on Brown's estimates with an addition thereto of approximately 5 per cent., which included an allowance of $2.50 per ton for some high-priced steel which Bethlehem had on hand or under contract and proposed to use, but which Brown had not taken into consideration (R. 686). At the conference between Powell, Brown, Bowles and Radford on January 3, 1918, the negotiations for the contracts that were dated December 31, 1917, were closed substantially on the basis of Brown's estimates (R. 686).

The courts below have found that Bowles was thoroughly competent to check Bethlehem's estimates, that the dealings between the parties were at arm's length, that the estimated base costs were arrived at by a process of barter and trade, and that they represented reasonable estimates of probable cost (R. 686, 688). They found further that

the form of contract adopted was a desirable one from the standpoint of both parties; that it was preferable to the straight cost-plus contract, because it provided an incentive to the contractor both to keep down the cost and to expedite the work; that the representatives of the Fleet Corporation were familiar with, and approved of, such form of contract; that the estimated cost named in the contracts was not intended to represent a close estimate of the bare cost of construction, but was intended to be sufficiently liberal to provide an incentive for efficiency and was so understood and accepted by the representatives of the Fleet Corporation; and that the latter, in connection with later contracts, adopted a formula for arriving at the base cost by adding to the estimated amount of so-called bare cost an amount to provide such incentive (R. 684-685).*

Moreover, the courts below have also found that prior to the conference on January 3, 1918, Powell, in a letter to Piez, Vice-President and General Manager of the Fleet Cor-

*It was the settled policy of the Fleet Corporation when using the above-mentioned form of contracts to see to it that base prices specified therein were sufficiently above bare cost to provide the necessary incentive to keep down costs. As found by the Master, under date of October 9, 1918, Piez submitted a memorandum to the Board of Directors of the Fleet Corporation from which the following is an extract (R. 552):

> "In fixing these estimated basis costs, care must be exercised that they be not placed at too low a figure, for if they are, the probabilities are that the contractor will lose interest in keeping the cost down as soon as it finds that the ship will cost more than the estimated basis cost.
>
> "We discussed this matter with the Board at the time the commitments were made last Spring, and showed how we intended to fix the basis cost. At the suggestion of the Board, our method of fixing the

poration, dated January 3, 1918 (Exhibit G-116, R. 1831), had agreed on behalf of Bethlehem "to accept the order to construct these vessels on such terms as may be personally determined by Mr. Charles Piez, the Vice-President and General Manager" of the Fleet Corporation (R. 531, 587-588).

As stated above, subsequent to the execution of the 8 contracts that were dated December 31, 1917, 10 additional contracts were entered into between the same parties, 6 of which are included in the 13 contracts referred to in the petition. Such 6 contracts provided for the construction of ships of types similar to those covered by the earlier contracts, and one of them (Contract 314, R. 270) covered in addition the construction of 7 cargo ships of a new and smaller type than any covered by the other contracts. That in the case of each of such 6 contracts the terms were fixed by the Fleet Corporation is shown by the correspondence between it and Bethlehem as follows:

Contract No. 226 (R. 197) covers four 10,100 ton tankers and three 7,400 ton cargo vessels to be built at the Sparrows Point plant. Bethlehem's proposal contained in its letter of February 25, 1918 (Exhibit G-125, R. 1836) suggested the same base prices and fixed fees as under Contracts Nos. 178 and 179 (R. 122 and 139) covering the same types of vessels, namely $1,350,000 and $125,000 for the cargo ships and $2,070,000 and $200,000 for the

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basis cost was not kept on the record, the Board fearing that such a record might be an embarrassing precedent."

While such memorandum related to contracts for the construction of troop ships, it is descriptive of the Fleet Corporation's understanding of the composition and purpose of base prices to be inserted in such form of contract.

tankers. On March 7 Powell wrote referring to this proposal (Exhibit G-126, R. 1838):

> "Please be advised that this Company cannot offer these vessels to the Emergency Fleet Corporation on any lower basis than that quoted in our letter above mentioned, since its mature judgment leads it to believe that a less price will not yield a living profit. However, because of its full appreciation of the Nation's desperate need of ships, it desires to repeat the offer made orally and in writing in December and January last, that it will accept the order to construct these additional vessels at such lower base price and such smaller fee as may be personally determined by Mr. Charles Piez, Vice-President and General Manager, with the proviso in the present instance that the contracts will otherwise be duplicates of those for new construction already signed by the Bethlehem Shipbuilding Corporation, Ltd. and the Emergency Fleet Corporation."

To this letter Piez replied under date of March 18 (Exhibit G-127, R. 1839), reducing the base prices to $1,295,000 and $2,000,000, respectively, the fixed fees to remain the same as in the previous contracts.

Contract No. 230 (R. 210) covers 2 additional stock ships to be built at Union, Hulls 215-216. In its letter of January 17, 1918 (Exhibit G-122, R. 1833), Bethlehem proposed a base price of $2,124,000 and fixed fee of $212,400, the same as for Hulls 150 and 153. In its letter of April 8, 1918 (Exhibit G-128, R. 1840), the Fleet Corporation offered to take these vessels at a base price of $2,000,000 and a fixed fee of $200,000. Bethlehem objected to this in its letters of April 16, 1918 (Exhibit

G-130, R. 1841), but agreed to reduce the base price to $2,075,000 and the fixed fee to $207,500, which proposition was accepted by the Fleet Corporation in its letter of April 22, 1918 (Exhibit G-133, R. 1847).

Contract No. 299 (R. 222) covers three 9,100 ton tankers to be built at Fore River, duplicates of the tankers covered by Contract No. 183 (R. 158). Bethlehem's proposal, which is contained in its letter of April 18, 1918 (Exhibit G-132, R. 1843), suggested the same base price and fixed fee, namely, $1,865,000 and $185,000. The Fleet Corporation's letter of April 30, 1918 (Exhibit G-134, R. 1848), reduced the base price to $1,850,000 and left the fixed fee at $185,000.

Contract No. 300 (R. 234) covers three 10,100 ton tankers and Contract No. 312 (later canceled) covered three 7,400 ton cargo boats to be built at Sparrows Point, duplicates of vessels covered by Contract No. 226. Bethlehem's proposal, which is contained in its letter of April 18, 1918 (Exhibit G-132, R. 1845), suggested the same base price and fixed fee as under the previous contract. The Fleet Corporation's letter of April 30, 1918 (Exhibit G-134, R. 1848), accepted the same base price and fixed fee on the tankers, but in its letter of May 15, 1918 (Exhibit G-135, R. 1849), reduced the base price on the cargo vessels to $1,250,000, leaving the fixed fee at $125,000 the same as under the earlier contract.

Contract No. 301 (R. 246) covers six 10,100 ton tankers and six 11,800 ton cargo vessels to be built at Union, the tankers to be duplicates of the tankers under Contract No. 177 (R. 109) and the cargo vessels duplicates of the Hulls 215-216 covered by Contract No. 230 (R. 210). Bethlehem's proposal, which is contained in its letter

of April 18, 1918 (Exhibit G-132, at R. 1845), suggested the same terms as under the previous contract, namely, $2,120,000 and $210,000 for the tankers and $2,075,000 and $207,500 for the cargo ships. The Fleet Corporation's letter of April 30, 1918 (Exhibit G-134, R. 1848), reduced the base price on the tankers to $2,100,000, the fixed fee, as well as the base price and fee on the cargo boats, remaining the same as under the previous contracts.

Contract No. 314 (R. 270) covers three 7,500 ton tankers and seven 5,100 ton cargo vessels to be built at Harlan, the tankers to be the same as those covered by Contract No. 178. Bethlehem's proposal, which is contained in its letter of April 18, 1918 (Exhibit G-132, R. 1844), suggested the same terms for the tankers as under Contract No. 178 ($1,612,000 and a fixed fee of $160,000), and for the cargo vessels the base price of $1,045,000 and fixed fee of $105,000. In its letter of April 30, 1918 (Exhibit G-134, R. 1848), the Fleet Corporation wrote:

> "The question of three 7500 ton tankers and seven 5100 ton cargo vessels to be constructed at your Harlan plant and the three 7400 ton cargo vessels* to be constructed at your Sparrows Point plant, has been held in abeyance pending further investigation relative to the estimated base cost of the vessels in question."

On May 15, 1918, the Fleet Corporation by letter awarded to Bethlehem the Contract No. 314 on the basis of an estimated cost of $1,560,000 for each of the tankers and

*The 7400 ton cargo vessels were those covered by Contract No. 312 referred to above.

of $980,000 for each of the cargo boats, with a fixed fee of $156,000 and $98,000, respectively (Exhibit G-135, R. 1849).

In respect of the above-mentioned later contracts the Master's report is as follows (R. 554):

> "The evidence shows, and the Master finds, that as to the later contracts the representatives of the Fleet Corporation had opportunity, which they took advantage of, to determine whether the 'base cost' of Bethlehem would produce a higher net cost to the Government than those contracts of other shipbuilders, and that as a result of deliberate judgment they fixed the 'base cost' of all these contracts at what was believed to be as fair and reasonable as could be estimated under all of the existing circumstances (see G. 134, Doc. 391*)".

Concerning all the contracts referred to in the petition the courts below have found that the estimated base costs used in them represented reasonable estimates of probable cost; that there was no misrepresentation on the part of Bethlehem in the negotiation of them; and that they were fairly negotiated and were agreed to by the parties as the best that could be made under the circumstances (R. 688, 689).

The courts below also found that the cost to the Government of the ships built under the Bethlehem contracts was less than the cost of comparable ships under either lump sum or cost plus contracts made by the Fleet Cor-

*R. 1848.

poration with other shipbuilders (R. 554, 568) or in other words that the form of the contracts that was adopted accomplished its purpose.*

ARGUMENT

I.

THE CONTENTION OF THE PETITION THAT THE CONTRACTS ARE UNCONSCIONABLE BECAUSE OF THE AMOUNT OF PROFIT EARNED BY THE CONTRACTOR IS NECESSARILY BASED ON THE CONTENTION THAT THE AMOUNTS OF ESTIMATED COST SPECIFIED IN THE CONTRACTS WERE, AT THE TIME OF THE MAKING OF THE CONTRACTS, IN EXCESS OF PROBABLE COST AND KNOWN TO THE CONTRACTOR TO BE SUCH. HENCE IT IS PREDICATED ON QUESTIONS OF FACT WHICH HAVE BEEN DECIDED AGAINST THE PETITIONERS BY THE COURTS BELOW.

The whole contention of the petition that the contracts in controversy should be held to be unconscionable is based on the assumption that the amounts of estimated cost

*This finding is based upon an elaborate set of exhibits comparing the costs of the various types and sizes of ships built by Bethlehem with similar types and sizes of ships built by others based upon data as to the cost of the latter ships furnished by the Fleet Corporation (Exhibits B-3, B-4, which were sent up to the Circuit Court of Appeals as physical exhibits pursuant to the order at R. 1932) and upon the testimony of Brown who prepared them in explanation of them and of the showing made by them (R. 1094-1125, 1136-1140).

agreed upon between the parties and specified in the contracts were inflated (petition, p. 14) or swollen (petition, p. 13). That contention presents a question of fact which the courts below have decided against the petitioners. As we have shown above, those courts have found that, in view of the uncertainty of conditions affecting costs then existing, it was impossible to make an accurate estimate of cost (R. 681); that Brown's estimates were fairly and honestly made and were as accurate as could be expected under the uncertain conditions prevailing at the time (R. 683); and that the estimated base costs specified in the contracts represented reasonable estimates of probable costs (R. 686, 688).

The contention of the petition that the costs were inflated is based solely on the amount of profits earned by Bethlehem under the contracts. With this as its sole basis, the petition proposes that this Court should review the decision of the courts below and should draw the inference that the amounts of estimated costs specified in the contracts were in excess of the amounts of probable cost and were known to Bethlehem to be such when the contracts were made. The courts below have specifically refused to draw such an inference. In their requested finding No. 278 (R. 678) the petitioners requested the Master to find that the "savings" resulted from the gross and improper inflation of the estimates of cost designated as base prices in the respective contracts. The Master's ruling on this request was "Denied. This is not justified by the evidence." The Master's ruling in this respect, as in others, was adopted by the District Court (R. 760) and was confirmed by the Circuit Court of Appeals (R. 2327).

This Court has repeatedly declared that findings of fact concurred in by two lower courts will be accepted by this

Court unless clear error is shown.* As we have shown above, the findings of the court below concerning the amounts of estimated base cost stipulated in the contracts are supported by ample evidence. There is no evidence in the record that they were not within the range of probable cost, and the courts below have found that they were. Under the established policy of this Court, it will not review on certiorari the decision of the Circuit Court of Appeals for the purpose of determining whether this Court might draw, solely from the amount of profit earned by Bethlehem under the contracts, an inference contrary to the specific findings of the Master, of the District Court and of the Circuit Court of Appeals.

II.

THE CONTRACTS MUST BE JUDGED, AS TO WHETHER THEY ARE UNCONSCIONABLE, IN THE LIGHT OF CONDITIONS EXISTING WHEN THEY WERE MADE AND ON THE BASIS OF THE TOTAL COST OF THE SHIPS TO THE FLEET CORPORATION, NOT ON THE BASIS OF THE AMOUNT OF PROFIT EARNED BY THE CONTRACTOR.

Three forms of contract were open to the parties, viz.: lump sum, cost plus a percentage of cost, or cost plus a fixed fee plus a percentage of savings, if any, under an

United States v. *O'Donnell*, 303 U. S. 501; *Pick Manufacturing Co.* v. *General Motors Corporation*, 299 U. S. 3; *I. T. S. Rubber Co.* v. *Essex Rubber Company*, 272 U. S. 429; *Texas & New Orleans Railroad Company* v. *Brotherhood*, 281 U. S. 548; *United States* v. *Commercial Credit Co., Inc.*, 286 U. S. 63; *Page* v. *Arkansas Natural Gas Corporation*, 286 U. S. 269; *Gilson* v. *United States*, 234 U. S. 380.

estimated base cost—the form adopted. The Master found that the form of contract adopted "was a desirable one from the standpoint of both parties" and "preferable to the straight cost-plus contract, because it provided an incentive to the contractor both to keep the cost down and expedite the work" (R. 684), and both the District Court (R. 760) and the Circuit Court of Appeals (R. 2330) affirmed that finding. Piez, the Chief Executive Officer of the Fleet Corporation, so testified (R. 1498-1499). In so far as the petitioners' argument rests upon Bethlehem's supposed insistence* upon the "bonus-for-savings" clause (petition, p. 13), it falls to the ground. The use of this form of contract, so far from being unconscionable, was shown by the uncontradicted evidence, found by the Master and confirmed by both courts below to have been advantageous both to the Fleet Corporation and the Contractor.

The Master also found that, in order that the benefits sought to be derived by the Fleet Corporation from the use of this form of contract might be received, it was "essential that the estimated or base cost should be sufficiently liberal to afford a reasonable opportunity to the contractor to cut under it" (R. 684-685) and that this was fully understood and approved of by representatives of the Fleet Corporation (R. 685). Those findings in common with all others were affirmed by both the District Court (R. 760-761) and the Circuit Court of Appeals (R. 2323-2332).

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*As shown above (pp. 11-12), so far from insisting either upon this form of the contract, or upon the allegedly "inflated" base prices submitted, Bethlehem as found by the Master (R. 531, 587-588) and affirmed by both courts below agreed "to accept the order to construct these vessels on such terms as may be personally determined by Mr. Charles Piez, the Vice-President and General Manager."

As hereinbefore pointed out, both the courts below held that the agreed upon estimated base costs represented reasonable estimates of probable cost. As appears from the foregoing, it was not only contemplated but essential, if the purpose of the contracts was to be accomplished, that they should also be "liberal" estimates of probable cost. The fact that they contained allowances for a probable decrease in the efficiency of labor—due to the anticipated influx of green labor in large numbers—and for anticipated increases in the cost of material, etc. (petition, pp. 7-8) did not and could not render the contracts unconscionable. Such allowances were clearly elements of "probable cost", which the parties, moreover, intended should be "liberal" and not "close".

Of course, the purpose of this form of contract and of the agreed upon base price was to provide an incentive to cut under so as to provide the Government with its ships at prices less than those built under either lump sum or straight cost plus contracts. The contracts—now charged to have been unconscionable—were productive of the desired result. The Master found that the cost to the Fleet Corporation of the ships constructed by Bethlehem under the contracts, now attacked, was less than the cost of comparable ships built for it under both cost plus and lump sum contracts (R. 554). The Government thus benefited by these contracts in precisely the manner in which it hoped to benefit therefrom, viz.: by keeping the cost of the ships down, through the provision of estimated base costs, affording to the Contractor both the opportunity and the incentive to cut under them, as the parties intended.

The only unconscionable thing about this case is the attempt of the Government—having obtained the benefit

sought—to escape payment in accordance with the terms of the contracts, through whose use such benefit accrued.

Thus the contention of the petition is not that the contracts should be held to be unconscionable because the cost to the Fleet Corporation of the ships constructed under them would be excessive, but only because Bethlehem earned under them greater profits than the petitioners think that the Government should be required to pay. There can be no doubt on the Record that it was the intention of the parties that the amounts of estimated cost specified in the contracts should be so fixed as to give the Contractor an opportunity, if it did its job well, to earn substantial profits under the half-savings clause. As stated above, in its letter of December 13, 1917 (Finding 11, R. 683), referring to the basis of estimated cost to be employed in the contracts, Bethlehem proposed:

> "The basis of fees and estimated cost to be such as to offer a reasonable probability of a net earning *after paying all War and Excess Profit taxes* as today existing of Ten Percent (10%) of the present estimated cost of construction." (Italics supplied.)*

As to the composition and purpose of the base price, Piez, Vice-President and General Manager of the Fleet Corporation, who had had experience with incentive contracts in his manufacturing business, testified as follows (R. 1500-1501):

> "A. The price had to be placed for actual cost, if we knew the cost, plus an allowance for contingencies, plus an allowance for incentive, plus the fee. So we start out with the bare cost; then in order to meet any contingencies that may happen,

*There is no evidence that Bethlehem made more.

> add some allowance for contingencies; in order to give a proper incentive, add an incentive allowance; and then add the fee."

Later on, as the Master found, the Fleet Corporation adopted a formula for arriving at the base cost by adding to the estimated amount of so-called bare cost an amount to provide the necessary incentive to cut under it (R. 685). Indeed, as is further shown in the Master's report, having reference to Exhibit B-6 (R. 1900), it became, in the Spring of 1918, the settled policy of the Fleet Corporation, when using this form of contract, to see to it that base prices were sufficiently above bare cost to provide the necessary incentive to keep the cost down (R. 551-552). In this connection the District Court said (R. 740):

> "In viewing the 'unconscionable profits' phase of it, there is this to be said. The motive for the insertion of the bonus feature is obvious. Unless the promise was of substantial profits, the incentive to keep down the cost would be lacking."

In the same connection, the Circuit Court of Appeals said that the Government's representatives accepted the terms of the contracts "with full knowledge, as we have said, that the estimated cost figures included in the contracts did not represent close approximations but were so prepared as to assure to Bethlehem substantial additional profits by way of the bonus for savings." (R. 2328)

The result sought to be attained by the form of the contracts entered into was to keep the cost down, and thus to save the Government money. The means adopted for the attainment of that end was the simple device of providing a base price, sufficiently liberal to afford the con-

tractor an opportunity to cut under it, and of dividing with him the difference between such base price and the actual cost, if lower. As we have shown above, the courts below have found in the present cases that it was productive of the desired result.

In their petition the petitioners refer to a finding by the Master that there was no evidence that the cost of construction of the respective tank and cargo ships in controversy was reduced as a result of the "bonus-for-savings" provisions of the respective contracts. It is not clear to us what such finding was intended to mean. It is inconsistent with the finding to which we have last referred, unless it was intended only to mean that Bethlehem had not undertaken to show what the cost of the ships would have been in the absence of the "half savings" clause of the contracts. In that connection, it should be noted that the Circuit Court of Appeals said that the record contains evidence tending to show that the savings resulted, in part at least, from increased efficiency (R. 2330)*; in other

*This in part has reference to Exhibit B-32, which was ordered sent up to the Circuit Court of Appeals as a physical exhibit by the order at R. 1932, and which showed a breakdown prepared by a witness for the Government of the costs of the contract ships divided as between material, labor and plant operating and overhead expense. By comparison of the labor cost incurred under successive contracts for identical ships it shows a progressive decrease in labor cost of ships built under the later contracts as compared with the labor cost of identical ships built under the earlier contracts, thus reflecting a progressive increase in the efficiency of labor during the performance of the contract program. A like result is shown in Exhibit B-33 (R. 1931), which shows a comparison of labor hours expended on Hulls 376, 377 and 378, built under Contract 183, and labor hours expended on identical Hulls 379, 380 and 381, built under Contract 299.

words, that the form of the contracts accomplished its purpose.

The Government has thus benefited from the contracts in precisely the manner in which it hoped to benefit therefrom; namely, by keeping the cost of the ships down through the provision of base prices affording to the Contractor both the opportunity and the incentive to cut under them. When the contracts were made it was, as the courts below have found, impossible to estimate what the cost of construction would be or how much additional profit by way of half-savings Bethlehem might make under them. That Bethlehem did its job well is shown both by the amount of savings that it accomplished and by the fact that after payment in full of the amounts provided in the contracts the ships will have cost the Government less than comparable ships built under contracts with other shipbuilders.

The contracts must be judged by conditions existing at the time, the purpose sought to be achieved and the results accomplished under them and not by the amount of profit that Bethlehem was able to earn.* The classic definition of an "unconscionable contract" is that of Lord Hardwicke

*Moreover, in respect of the profits earned the Circuit Court of Appeals aptly said (R. 2329):

> "It must be recalled, as the special master pointed out in his report, 'that Bethlehem was an old line shipbuilding company, carrying the burdens of idle invested capital over long-time periods, the maintenance of an experienced and expensive organization, which, during periods of inactivity in the shipbuilding industry, probably was not productive of overhead, such as maintenance, taxes, and other carrying charges. All of these, however, were charges incident to the standby

in *Earl of Chesterfield* v. *Janssen*, 2 Ves. Sen. 125, 155, to-wit:

> "such as no man in his senses and not under delusion would make on the one hand and as no honest or fair man would accept on the other."

In no subsequent case which has come to our attention, including those cited in the petition, has any contract been held unconscionable unless the total amount to be paid was so exorbitant and made under such circumstances as to bring it within that definition.

The estimated costs specified in the contracts under consideration represented reasonable estimates of probable cost (R. 688). Hence it was characteristic of the form of contract adopted that the greater the profit earned by the Contractor under the "half-savings" clause, the less would be the cost of the ships to the Fleet Corporation. Such was the purpose of the contracts. The fact that Bethlehem accomplished that purpose by doing its job well, and thereby earned substantial profits under the "half-savings" clause, at the same time saving expense to the Fleet Corporation and enabling it to get the ships for less than it was paying to other shipbuilders for comparable ships, presents no

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service rendered by Bethlehem, to enable it to perform active service when the needs of the Government might require it. It may well be, as Bethlehem contends, that these factors must have been taken into consideration by the representatives of the Fleet Corporation in their determination that, regardless of the opportunity which the contracts would afford to Bethlehem for substantial profits, it was worth the extra cost, if any, to the Government to place the contracts with an old line company and to insure the continuous service of Bethlehem so long as the war needs might call for it.'"

basis for the contention that the contracts in controversy or the half-savings provision of them can be held to be unconscionable.

The foregoing considerations dispose also of the contentions of the petition that the contracts are opposed to public policy and were beyond the authority of the Fleet Corporation to make.

III.

ON THE CONTENTION PRESENTED IN THE PETITION THAT THE PROVISIONS OF THE CONTRACT FOR PAYMENT OF COMPENSATION TO THE CONTRACTOR CAN BE SEVERED AND THAT THE PROVISION FOR THE PAYMENT TO IT OF ONE-HALF OF THE SAVING ACCOMPLISHED UNDER ESTIMATED COST REQUIRES PROOF OF SEPARATE CONSIDERATION IN THE PERFORMANCE OF THE CONTRACT, THERE IS NO CONFLICT BETWEEN THE DECISION OF THE CIRCUIT COURT OF APPEALS AND THAT OF ANOTHER CIRCUIT COURT OF APPEALS. THE DECISION OF THE COURT OF CLAIMS IN THE *BURKE & JAMES, INC.* CASE, CITED IN THE PETITION, IS READILY DISTINGUISHABLE.

Under the contracts referred to in the petition the consideration moving to the Fleet Corporation was the construction of the ships contracted to be built. The consideration moving to the Contractor was the price to be paid for their completion. The provision for participation in savings was as much a part of that consideration as the reimbursement of cost and the payment of a fixed fee. The contention of the petition, however, is that that provision

is severable from the other provisions of the contracts concerning the compensation to be paid to the Contractor, and *Burke & James, Inc.* v. *United States,* 63 Ct. Cls. 36, is cited in support of the contention. The same contention was made before the Master, who said (Report, R. 555):

> "The Government relies upon the case of *Burke & James, Inc.* v. *United States,* 63 Court of Claims Reports 36, as authority for its request that the Master shall find that the contract is unenforceable because it may produce for Bethlehem an unconscionable and grossly excessive profit. The Master has examined the *Burke & James* case, and is of opinion that the facts upon which the decision of that case was based are so different from the facts appearing in the record before the Master that the rule applied by the Court of Claims is not applicable here."

That opinion of the Master was adopted by the District Court (R. 760), and the Circuit Court of Appeals concurred. The latter Court said (R. 2330):

> "We agree with the Circuit Court of Appeals for the Sixth Circuit, which in *Dayton Airplane Co.* v. *United States,* 21 F. 2d 673, had a similar contract before it, that this form of contract was a proper one and not against public policy and that the bonus for savings provision which formed part of the consideration for Bethlehem's agreement to build the ships may not, alone of all the provisions in the contract, be set aside as unenforceable and void."

In the *Dayton Airplane Co.* case the Circuit Court of Appeals for the Sixth Circuit had said:

> "Even if the subject were othe. wise open, it would be difficult to set aside only one contract provision which formed a part of the consideration for the counter-promises."

The facts of the *Burke & James* case are so different from the facts as found by the courts below in these cases that there is no real conflict between the decision of the Court of Claims in that case and the decision here. In that case the Court quoted from its decision in an earlier case, not here in point, as follows (p. 53):

> "The test in such cases is whether or not there was any benefit to be derived by the United States."

As we have hereinabove shown, it was not only anticipated by the parties that the Government would benefit from the "half-savings" provision of the contracts, but it actually did so.

Moreover, it appears in that case that the Government relied upon the accuracy of the plaintiff's estimate (p. 52), which the Court said was the result of an "egregious" (p. 53) or "gross" (p. 59) error by which the Government was misled (p. 59) and induced "to erroneously bind itself to pay for acticles to be supplied a sum largely in excess of their possible worth" (p. 53). In the present cases the representatives of the Fleet Corporation, as the courts below have found, did not rely on the estimates, which were found to be as accurate estimates of cost as could be expected in view of the uncertain conditions of the times (R. 683), and were not misled by the estimates submitted (R. 539; see also the denial of requests for findings concerning reliance on the estimates at R. 647, 648, 651, 653-654).

Moreover, the doctrine of the *Burke & James* case is a novel one, unsupported by any authority, that either the validity of a contract or the existence of a consideration therefor is to be determined by the results of its performance. Equally without precedent is the suggestion that where such a provision is contained in the original contract, as distinguished from a change made by a supplemental contract, as was the case in some of the earlier cases in the Court of Claims cited in the petition, some independent consideration therefor is required.

Failure of consideration cannot be found when the party asserting it gets what he bargains for. In this case the Government got exactly what it hoped to get out of the bargain; namely, the construction of ships at less cost than those constructed by any other contractor. The contracts operated just as the parties intended them to operate, and by the use of that "device" which Piez reported to the trustees (Ex. B-6, R. 1900; Master's Report, R. 552) had been found to be the most effective way of keeping costs down; namely, by dividing with the Contractor the difference between actual and estimated cost, however brought about, through the use of the simple mathematical formula that was written into the contracts.

Moreover, as the Circuit Court of Appeals pointed out (R. 2330), the statement, repeatedly made in the petition, that savings were not the result of increased efficiency is not correct.

The petitioners' contention is based primarily upon the assumption that, despite the express provisions of the contract to the contrary, it was understood that Bethlehem was to participate only in such savings as resulted from in-

creased efficiency. The Master refused to find that there was any such understanding. The only finding requested by the petitioners embodying the contention now made was their Request No. 173, which was denied. This Request and the ruling thereon were as follows (R. 637):

> "173. At the time of the negotiations relating to the respective tank and cargo ships in controversy, it was understood that under the 'half-savings' form of contract Bethlehem was supposed to participate only in such 'savings', if any, as were earned and made possible by its efforts and ability to reduce cost by increasing efficiency.
>
> "Denied. Bethlehem was to participate in savings however earned, but expected to produce savings by increased efficiency."

IV.

THERE IS NO AUTHORITY IN LAW OR ELSEWHERE WHICH WOULD WARRANT THE ADOPTION OF THE SUGGESTION MADE IN THE PETITION THAT CONDITIONS OF OUR PRESENT NATIONAL EMERGENCY ARE SUCH AS TO REQUIRE THIS COURT TO DEFINE THE LIMITATIONS SURROUNDING THE PROFITS WHICH A GOVERNMENT CONTRACTOR MAY LAWFULLY RECEIVE OR RETAIN IN TIME OF WAR.

It is suggested in the petition (p. 12) that the conditions of our present national emergency are such as to require this Court to define the limitations surrounding the profits which a Government contractor may lawfully receive or retain in time of war. As stated above in paragraph 4 of the Statement of Reasons Why the Petition Should be

Denied (pp. 4-5), we had assumed and believe that it is exclusively within the province of the Congress to define limitations of profits which a Government contractor may receive or retain, if it shall so desire—by statute, by prescription of contract provision or limitation, by the provisions of an excess profits tax, or by all three methods combined. It is so clear to us that there is no authority in law or elsewhere which would warrant the transfer of the determination of prices in Government contracts from the executive department to the judicial department and the determination of questions of policy in respect of Government contracts from the Congress to the courts that it does not seem to us to be necessary to add to what we have said in paragraph 4 of such Statement.

Conclusion

It is respectfully submitted that the petition for writs of *certiorari* should be denied.

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